



ITA No.6446/Mum/2016  
M/s. Girdharilal International Ltd.  
Assessment Year-2011-12

**आयकर अपीलीय अधिकरण "के" न्यायपीठ मुंबई में।**  
**IN THE INCOME TAX APPELLATE TRIBUNAL**  
**"K" BENCH, MUMBAI**

**माननीय श्री शक्तिजीत दे, न्यायिक सदस्य एवं**  
**माननीय श्री मनोज कुमार अग्रवाल, लेखा सदस्य के समक्ष।**  
**BEFORE HON'BLE SHRI SAKTIJIT DEY, JM AND**  
**HON'BLE SHRI MANOJ KUMAR AGGARWAL, AM**

आयकरअपील सं./ IT(TP)A. No.6446/Mum/2016

(निर्धारण वर्ष / Assessment Year: 2011-12

<b>DCIT-5(2)(1)</b> Room No.571, Aaykar Bhavan, M.K. Road Mumbai-400 020	<b>बनाम/ Vs.</b>	<b>M/s. K. Girdharilal International Ltd.</b> 101, Prasad Chambers 10 <sup>th</sup> Floor, Opera House Mumbai-400 004.
स्थायीलेखासं./जीआइआरसं./PAN/GIR No. <b>AACCK-6101-F</b>		
(□ पीलार्थी/ <b>Appellant</b> )	:	(प्रत्यर्थी / <b>Respondent</b> )

□ पीलार्थीकीओरसे/ <b>Appellant by</b>	:	Shri Jayant Kumar-Ld. CIT-DR
प्रत्यर्थीकीओरसे/ <b>Respondent by</b>	:	Dr. K.Sivaram and Shri Shashank Dundu

सुनवाईकीतारीख/ <b>Date of Hearing</b>	:	15/07/2019
घोषणाकीतारीख / <b>Date of Pronouncement</b>	:	03/10/2019

**आदेश / ORDER**

**Manoj Kumar Aggarwal (Accountant Member): -**

1. By way of this appeal, the revenue is contesting the correctness of decision of Learned Commissioner of Income Tax (Appeals)-56, Mumbai, [in short referred to as 'CIT(A)'], *Appeal No. CIT(A)-56/ACIT 5(2)(1)/2015-*



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16/112-K dated 20/07/2016 in deleting the penalty of Rs.12.79 Crores for Assessment Year 2011-12 as levied by learned AO u/s 271G vide order dated 30/07/2015.

2.1 Facts leading to imposition of penalty are that assessee being resident corporate assessee is stated to be engaged in the business of manufacturing of cut and polished diamonds studded jewellery. Certain international transactions carried out by the assessee with its Associate Enterprises (AE) during the year under consideration, were referred to Learned Transfer Pricing Officer (TPO) for determination of Arm's Length Prices. These transactions were in the nature of purchase / sale of rough as well as polished diamonds and sale of diamond studded jewellery. The approximate sale to AE was 23% of assessee's turnover whereas purchases were approx. 56% of total purchases. The assessee benchmarked the same using entity level TNMM. Although Ld. TPO accepted the transactions to be at Arm's Length Price, but initiated penalty u/s 271G in view of the fact that the assessee was unable to submit internal TNMM by working out the profitability of AE and non-AE segment.

2.2 The assessee explained that owing to its nature of business, it was not practical to identify and bifurcate the stock, cost and revenue between AE and non-AE segment and work out profitability of the two segments separately. However, concluding that the assessee failed to maintain documentation as required under Clause (g) and (h) of Rule 10D (1), the aforesaid penalty was initiated.



2.3 During penalty proceedings, reiterating the same, the assessee submitted that there was no uniformity in product classification of rough diamonds and assortment & mixing of rough diamonds would make it infeasible / impossible to track the source and cost of each piece of rough diamond and therefore, the profitability of the two segment separately could not be worked out. However, disregarding the same, Ld. AO levied penalty of Rs.12.79 Crores u/s 271G, being 2% of value of international transactions.

3.1 Before learned first appellate authority, it was again explained that the rough diamonds were procured from both AEs and non-AEs. The finished product of cut and polished diamonds would pass through a lengthy manufacturing process including assortment / re-assortment of rough diamonds and at initial stages, it would not be possible to forecast the final outcome of rough diamonds. During the process of manufacturing, a semi manufactured diamond would be assorted many times and handled by many craftsmen. Various direct and indirect expenditure would be incurred at various stages of manufacturing process and the rough diamond would ultimately lose its identity as to source of purchase due to inherent nature of diamond manufacturing process. Therefore, due to peculiar nature of the product and constant mixing and re-mixing of diamonds obtained from AEs and non-AEs, it would not be feasible to maintain records to determine segmental profitability to work out internal TNMM. Reliance was placed on several judicial pronouncements, as extracted in the impugned order, to submit that the penalty was unjustified.



3.2 The learned CIT(A), concurring with assessee's submissions, deleted the penalty by observing as under: -

**6. Decision:**

I have carefully considered the facts of the case, contentions of the TPO and submissions of the appellant & the detailed analysis is discussed herein below:

The TPO levied penalty u/s.271G on the ground that the appellant failed to furnish information called for. The TPO mentioned that the appellant inappropriately applied the TNM Method and despite the major irregularities in the entity level TNMM, the appellant adopted this method. Finally, the TPO rejected all the objections and held that appellant did not provide any basis for comparing the transactions of AE with another AE and/or non-AE and appellant failed to provide any alternative method for benchmarking the international transactions and the failure of the appellant resulted in and forced the TPO to accept the arms-length price as it is and thus preventing the TPO from examining and determining the arms-length price of various international transactions and hence levied penalty under section 271G of I.T.Act, 1961 of Rs. 12,79,00,2157- @ 2% of international transactions.

Before deciding the issue whether levy of penalty is justified or not, it is essential to know and understand the nature of diamond manufacture and trading business to appreciate the basic issues. Appellant in their submissions have described nature of diamond trade, its peculiarities as follows:

"The nature of the diamond industry and its peculiar features are given in the Schedule A and are briefly enumerated in the flowchart provided (based on Memorandum submitted by GJEPC to the Tax Authorities). The flowchart clearly demonstrates the peculiar nature of the diamond business and the key challenges in maintaining the records to extract separately the cost and profit from each transaction with AEs and non-AEs. The Schedule-A- The Nature & Peculiar Features of the Diamond Industry

I. Large category of rough diamonds

II. Multiple manufacturing processes

III. Humongous number of category of polished diamonds and their constant mixing & re mixing

IV. Sale of polished diamonds including diamonds of substantially low size from 0.01 carat to 0.10 carat

a. To summarise the above, in respect of manufacturing operations, the rough diamonds are procured from both AEs and non-AEs. The finished product of cut and polished diamonds passes through a lengthy manufacturing process including assortment / re-assortment of rough diamonds as observed from the aforesaid flowchart. Thus, at the initial stage it is not possible to forecast the final outcome of rough diamond. During the process of manufacturing, a semi manufactured diamond is assorted many times and handled by many craftsmen. Various direct and indirect expenses are incurred during the course of manufacturing. Resultant, a rough diamond loses its identity as to source of purchases due to inherent nature of diamond manufacturing process.



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b. The Appellant humbly submits that due to the peculiar nature of the product and constant mixing and re-mixing of the diamonds obtained from AE/non-AE, it faces constant challenge of identifying the origin of that rough diamond from which the finished cut and polished diamond is obtained. Due to such factors, it is therefore not feasible to maintain records to determine segmental profitability to work out internal TNMM. Brief mention of such factors are given below:

> Various categories of rough diamonds purchased and utilized for manufacturing. There is no uniformity in product classification of rough diamonds. Further, Assortment & mixing of rough diamonds result in non-feasibility to track the source of cost of each piece of rough diamond.

> There is no defined standard input output ratio in manufacturing of polished diamonds from rough diamonds. Further, manufacturing processes result in multiple pieces of polished diamonds from single piece of rough diamond based on yield varied from 10% to 55%. Diamond manufacturing is a multi-tier labour intensive process where different level of skilled labour is employed and no standard labour hours utilized resulting in non-feasibility to compute standard labour cost for polished diamonds manufactured. Further, due to continuous mixing of rough diamonds during manufacturing process resulted in non-feasibility to maintain records of cost for each piece of tiny polished diamonds.

> Humongous number of category of polished diamonds (approximately 12000 categories having different price range) and constant mixing & re mixing of numerous pieces of polished diamonds based on assortment and market requirement results in non-feasibility of maintaining records to identify origin source of cost. Further, the diamonds are not traded in single unit but in lots comprising of number of diamonds of different varieties and values.

The Company deals in variety of polished diamonds including diamonds' of very low range from 0.01 carat to 0.10 carat manufactured from different lot of rough diamonds results in non-feasibility of maintaining records to identify origin source of cost. Also, the size of the diamonds in certain cases is as small as grain of sugar, there is no standard mechanism and the Bar-coding concept cannot be applied."

In addition to the foregoing descriptions it is essential to know as to what happens in the Manufacturing & Trading of Diamond Business. Rough diamonds are mined from various places all over the world and they vary from a size of 0.05 carat to 10 carat usually and the price of rough diamonds vary on the composition of each lot of diamond consisting of various sizes, shapes and colours and weight and each lot is likely to have rough diamonds varying in size, shape, colour and weight.

It also remains a fact that no two rough diamonds in the lot are likely to be of the same size, shape, colour and weight which leads to anomalous situations when these are cut and polished. The process of cutting consists of pruning the edges, flattening the top and shaping the sides as to give the rough stone a final shape and then polish it. The entire process of cutting and polishing results in diamonds of different shapes and sizes depending upon the structure of the rough diamonds and the skills of the cutters and polishers of diamonds. Thus a lot of 100 carat of rough diamonds may usually yield 27% to 29% cut and polished diamonds of varying sizes and shapes and colours and weights (carats). Diamonds are weighed in carats



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and one gram is equal to 5 carats. Thus diamonds get cut and polished lot wise and even if each lot of rough diamonds is presorted before giving it for cutting and polishing, the polished diamonds are likely to vary in size, shape, size, colour and weight. Normally diamonds are exported and sold locally in lots and/or by weight of similar size and colour because these diamonds are then used by diamond jewellery manufacturers in the manufacture of diamond jewellery which requires diamonds of similar size, shape and colour while designing and making jewellery except for one unique piece which may be required for the ring or for centre of the necklace. Hence a diamond manufacturer is continuously required to sort out rough diamonds before giving for cutting and polishing which is done in stages and also sort out polished diamonds when the lots of cut and polished diamonds are received from the cutters and polishers to make lots of similar sizes, colours, shapes and weight before selling /exporting polished diamonds.

It is also worth mentioning here that normally polished diamonds of higher carat weight commands higher prices if other factors like size, colour and shape are same and/or similar and if there is variation, prices will again vary. Moreover, there is no standard price for a diamond in the world, because price varies with each diamantine who values the diamond and a broad price range can be fixed for diamonds of particular size, shape, colour and weight at a particular point of time. Moreover, diamonds are sold in lots of carats unless one diamond is of one carat or two carats in weight with unique features and shape and size. Thus determining the price of a diamond and /or diamonds is a difficult issue and even if the diamonds are physically evaluated, prices will vary from valuer to valuer.

This aspect of diamond trade is exhaustively explained by the GJEPC India in its letter dated 21/7/2015 addressed to the CIT-Transfer Pricing, Mumbai.

The TPO basically wanted the appellant to furnish separate profit level indicator (PLI), that is, AE and non-AE segment wise either the P & L Accounts and/or some other evidence to show that the international transactions were at arms-length price.

In the current scenario, it is difficult to identify and say whether a polished diamond came out of any particular lot of rough diamonds or the other and/or out of the polished diamonds locally purchased by the appellant. On understanding of export bills of cut and polished diamonds exported to AEs and non AEs reveals that diamonds of varying size, quality, colour and carat weight were exported as is evident from the price per carat charged in each bill. And may be similar situation must have existed in respect of cut and polished diamonds purchased and sold locally and/ or purchased from abroad but sold locally.

Therefore, it is extremely difficult even for the diamond trader and manufacturer to identify which rough diamond got converted into which polished diamond specifically unless the single piece rough diamond happened to be of exceptionally high carat value and weight making the tracing out and identification of the polished diamond physically possible and convenient. Only indication about the size may come from the market price realised per carat unless each diamond is subjected to pre checking as done by the trader and manufacturer before selling and exporting to realise a better price per carat of the lot. Therefore, it is extremely difficult for the trader to identify each rough diamond piecewise unless the rough diamond is exceptionally of high carat value by weight and similarly, it is also difficult to identify each cut and polished diamond vis-a-vis the original rough diamond from which it was cut and polished. The TPO asked for details of PLI- Profit Level Indicator, that is, segment wise Profit and Loss Account of



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the AE segment and non-AE segment in respect of export of goods as well as local sales to arrive at arms-length price in respect of international transactions. Appellant explained the difficulties to the TPO in various letters described earlier, however, the TPO merely accepted the arms-length price as it is and initiated the penalty proceedings under section 271G of I.T.Act, 1961. The TPO could have tried to work out the gross profits and net profits by averaging the purchase prices and the expenses in proportion of export sales of each one of the three segments, as has been done by the appellant during penalty proceedings to arrive at average profitability of each segment and then to compare the same with the average profitability of other public/private companies whose details were made available in TP Study Report. In this regard, the TPO had another option of asking for the copies of P & L Accounts and the Balance Sheets of the AEs to make an overall comparison with the gross profitability levels of the appellant with AEs to ascertain diversion of profits, if any, in broad manner. However, this was not done by the TPO and the TPO went ahead with the levy of penalty of Rs.12,79,00,215/- under section 271G of I.T. Act, 1961. In the instant case, in submissions before the TPO during penalty proceedings it was pointed out that the appellant's margins are higher than margins of the AEs.

The TPO has gone straight to fault finding business without understanding the intricacies of diamond manufacture and trading business and instead of determining the arms length price by asking for P & L Accounts and Balance Sheets of the AEs and then comparing the financial ratios in general, gone ahead and levied penalty of Rs.12,79,00,215/- on the appellant. Prima facie, the levy of penalty under section 271G of I.T. Act, 1961 is neither fair nor reasonable and is also not justified in facts of the case mainly the intricacies of the diamond trade and lack and non-availability of knowledge in public domain about the manufacture of diamond trade.

The appellant has also submitted that when the appellant had furnished all the particulars on the basis of which the TPO could have come to the conclusion regarding ALP in the case of International Transaction and further submitted that the TPO had not asked for only one specific detail but several details on several occasions from time to time. Even the explanation for the specific details of segmental AE, Non-AE transactions were also filed and submitted. Thus, it appears that the appellant had made substantial compliance with the requirements of filing all major information called for by the TPO for determination of the ALP and accordingly, the ALP was accepted by the TPO. Further, the appellant relied on the Hon'ble High Court of Delhi in the case of CIT vs. M/s. Leroy Somer & Controls (India) Pvt. Ltd. which observed as under:

"The decision and observation of the Hon'ble High Court of Delhi in Income Tax Appeal No. 410/2012 (decided on 30.08,2013 in the case of CIT-2 vs. M/s. Leroy Somer & Controls (India) Pvt. Ltd.), which confirmed the ITAT decision and dismissed the revenue appeal on the subject of penalty u/s. 271G supports this stand fully. Inter alia, the Hon'ble High Court after discussing the provisions of 92D, 271G & Rule 10D states as under:

"The tribunal has rightly concluded that with such a broad rule, which requires documentation and information voluminous and virtually unlimited, Section 271G has to be interpreted reasonably and in a rational manner..... When there is general and substantive compliance of the provisions of Rule 10D, it is sufficient.....The documentation or information should be one specified in



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Rule 10D, which has been formulated in terms of section 92D(1) of the Act. Looking from any quarter and angle, the appeal of the Revenue is misconceived, totally lacking in merits and is, therefore, dismissed".

The appellant has also cited the below mentioned decision of Hon'ble ITAT which is as under:

The following observations of Hon'ble ITAT Bench "B", Chennai in the case of DCITvs. Magick Woods Exports (2012) 32 CCH 0422 Chen. Trib, which had concluded that penalty u/s. 271G cannot be imposed where assessee proves that there was reasonable cause for particular failure is also necessary to be considered.

"12. Moreover, in spite of all these things, the TPO has not suggested any adjustment in the ALP reported by the assessee. When that is the case, the default if at all any in the hands of the assessee, turns out to be a technical default.

13. The levy of penalty under section 271G is to be considered in the above circumstances. The penalty prescribed under section 271G is very severe. The quantum of penalty is 2 percent of the value of the international transaction for each failure on the part of the assessee. If there are more failures on the part of the assessee, the penalty may end up almost in a capital punishment. When the penalty provision is very severe, it should be applied with great caution and only if circumstances sufficiently justify invoking the penal provision".

I have gone through the above and found that the facts of the above case laws are similar to the facts of the appellant's case. In view of the above, I am of the opinion that levy of penalty u/s.271G of the I.T.Act,1961 is neither fair nor reasonable and therefore it is not justified in facts of the case, viz., the nature of diamond trade, substantial compliance made by the appellant and the reasonable cause showed by the appellant and above all, when there is no adjustment made in the ALP, Thus, the levy of penalty of Rs. 12,79,00,2157- under section 271G of I.T.Act, 1961 is hereby deleted.

In this regard, reliance is also placed on following decisions:

- 1) ITO V/S. Nets Soft India Ltd. -2013/35/Taxmann.Com/579/Mumbai ITAT
- 2) ACIT V/S. Gillette India Ltd.-2015/54/Taxmann.Com/313/Jaipur ITAT

In view of the fact that levy of penalty under section 271G of I.T.Act, 1961 is itself deleted, other objections raised by the appellant before the TPO and in appeal are not considered relevant and are not discussed.

In the result, the appeal of the appellant is Allowed.

Aggrieved revenue is in further appeal before us.

4. We have heard and considered the rival submissions and deliberated on judicial pronouncements as cited before us.

5. Upon due consideration, the undisputed position that emerges is that the assessee has carried out certain international transactions during the year with its AE and benchmarked the same using TNMM method in its





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Transfer Pricing Study which has been accepted by Ld. TPO. The only basis of levying impugned penalty against the assessee is the fact that the assessee did not furnish internal TNMM by providing segmental profitability of AE and non-AE transactions. The same stood explained by the inherent nature of business being carried out by the assessee which has already been enumerated by us in the preceding paragraphs. The Ld. first appellate authority, while deleting the penalty, relied upon the binding judicial decision of Hon'ble Delhi High Court rendered in **CIT Vs. M/s. Leroy Somer & Controls (India) Pvt. Ltd. (37 Taxmann.com 407)** and other decision of the Tribunal rendered on similar factual matrix. We also find that similar factual matrix stood covered in assessee's case by the recent decision of coordinate bench of this Tribunal rendered in **DCIT V/s Leo Schachter Diamonds India Pvt. Ltd. (ITA No.5931/Mum/2017 order dated 28/02/2019)** which in turn, *inter-alia*, placed reliance on the decision rendered in **DCIT V/s Firestone International Pvt. Ltd. (ITA No. 5304/Mum/2016 dated 01/12/2018)** and the decision of Jaipur Tribunal in **ACIT V/s Gillette India Ltd. (54 Taxmann.com 313)**. Similar is the ratio of following decisions: -

1. ACIT vs. SSL-TTK (2012) 52 SOT 20 (URO) (Chennai)(Trib.)
2. ITO vs. Netsoft India Ltd. (2014) 150 ITD 454 (Mum.)(Trib.)
3. ACIT vs. D. Navinchandra Exports (P.) Ltd. (2017) 87 taxmann.com 306 (Mum)(Trib.)
4. ACIT vs. M/s. Dilipkumar V. Lakhi [ITA No.2142/M/2017, A.Y. 2011-12 dated 02.08.2018 (Mum.)(Trib.)
5. Dy.CIT vs. Interjewel Pvt. Ltd. [ITA No.5628/M/2016, AY 2011-12 dated 01/11/2018]



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The revenue is unable to point out any distinguishing features and also unable to place on record any contrary judgment to dislodge the ratio of these decisions.

In view of the aforesaid position, we find no infirmity in the impugned order in deleting the penalty u/s 271G.

6. Resultantly, the appeal stands dismissed.

*Order pronounced in the open court on 03<sup>rd</sup> October, 2019.*

**Sd/-**  
**(Saktijit Dey)**

न्यायिक सदस्य / **Judicial Member**

**Sd/-**  
**(Manoj Kumar Aggarwal)**

लेखा सदस्य / **Accountant Member**

मुंबई Mumbai; दिनांक Dated : 03/10/2019  
Sr.PS:-Jaisy Varghese

**आदेश की प्रतिलिपि □ ग्रेषित/Copy of the Order forwarded to :**

1. अपीलार्थी/ The Appellant
2. प्रत्यर्थी/ The Respondent
3. आयकर आयुक्त(अपील) / The CIT(A)
4. आयकर आयुक्त/ CIT– concerned
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई/ DR, ITAT, Mumbai
6. गार्डफाईल / Guard File

**आदेशानुसार/ BY ORDER,**

**उप/सहायक पंजीकार (Dy./Asstt.Registrar)**  
**आयकर अपीलीय अधिकरण, मुंबई / ITAT, Mumbai.**